NO. 18795

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

SIDNEY MARTIN,

Plaintiff and Appellant,

vs.

SAMUEL ROSENBAUM,

Defendant and Respondent.

RESPONDENT'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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Los Angeles 48, California

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TOPICAL INDEX

TABLE OF AUTHORITIES

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STATEMENT OF THE CASE

As is apparent from the Referee's Findings of Fact, respondent Samuel Rosenbaum was for many years conducting a retail meat business in New Jersey, purchasing his meat supplies from the appellant Sidney Martin, on an open book account. The amount owing to appellant varied between $1,400.00 and $5,500.00. Respondent came to California and on January 24, 1961, filed a Voluntary Petition in Bankruptcy, listing appellant as an unsecured creditor on a judgment for $4,057.00 plus interest. Appellant filed his unsecured creditor's claim, alleging that the consideration for the debt was meat products sold and delivered upon fraudulent representations. The claim alleged that a judgment was entered in

the Los Angeles Superior Court and that a certified copy of said judgment was attached to the claim. However, no certified copy of said judgment was ever attached to the claim or introduced into evidence. No objection to the discharge of the bankrupt was filed and the Final Discharge in Bankruptcy for respondent was entered on October 26, 1961. After the entry of the Final Discharge the appellant commenced proceedings in the Los Angeles Superior Court for the purpose of attempting to enforce the judgment theretofore entered by default against the respondent herein. Respondent sought and obtained a permanent injunction from the United States District Court referee restraining appellant from enforcing or taking any other action on the Los Angeles Superior Court Judgment on the ground that the Superior Court Judgment was not based on fraud and therefore was discharged by the debtor's discharge in bankruptcy. The referee's action was upheld on review by the District Court Judge. The issue before this Court is the propriety of the above ruling.

SUMMARY OF ARGUMENT

In his opening brief, appellant states: "In his Conclusions of Law (Tr. 62-63) and specifically, Conclusion of Law No. IV, the Referee below found that he had the equitable jurisdiction to determine whether appellant's claim was dischargeable, that the Court had the primary and superior jurisdiction, and that exhaustion by the bankrupt of his state remedies was not a prerequisite to the

exercise of the Court's injunctive power. With these Conclusions, we have no argument." Thus, the equitable jurisdiction of the U. S. District Court to determine whether appellant's claim was dischargeable, and the necessity of exhausting state remedies as a prerequisite to the exercise of the Court's injunctive power, are not in issue.

Appellant, in his Conclusion (Appellant's Brief, p. 46), states:

"Essentially, we submit, the issue presented is whether, as a matter of law, this Court can determine that the Referee below erred in taking extrinsic evidence and in reconsidering a fraud judgment entered after a default by the judgment debtor." That is not exactly the issue in this case because there was no fraud judgment. Assuming, but not conceding, that the failure of the appellant to attach a copy of said judgment to his creditor's claim and the failure of appellant to introduce into evidence a copy of said judgment in the proceedings before the Referee are not fatally defective to appellant's case, we submit that the basic issue is whether the Referee was justified in taking evidence to determine whether or not the debt sued on in the Superior Court action was, in fact, created by fraud, in view of the uncertainty of the judgment.

An examination of the record reveals that the debt relied on by the appellant was incurred in the ordinary course of respondent's business and was not a debt induced by respondent's fraud, and that respondent came to California in an effort to make a new

start in life and not to be burdened by his pre-existing obligations. Appellant has taken advantage of respondent's financial difficulties and has obtained a default judgment on a complaint, one of whose causes of action alleges fraud. Although the issue of fraud was never actually litigated, nor was fraud ever actually proved in the State Court action, appellant seeks to take advantage of respondent's failure to respond to his complaint and is saying that because the complaint alleges, among other things, fraud, and because a default was entered on that complaint, that the debtor's discharge in bankruptcy is of no effect against this creditor and that this creditor may harass the debtor until the debtor is either in some way able to satisfy the claim or to relocate himself outside of the creditor's grasp.

ARGUMENT

I.

THE RESOLUTION OF THIS APPEAL MUST TAKE INTO ACCOUNT THE UNDERLYING PURPOSE OF THE FEDERAL BANKRUPTCY ACT.

In Local Loan Co. v. Hunt, 292 U.S. 234 (1934), the United States Supreme Court sustained a decree enjoining a creditor from proceeding to enforce an assignment of wages. In upholding the lower court's exercise of its injunctive power to so restrain the creditor, the Supreme Court stated:

"One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight

of oppressive indebtedness and to permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes'. Williams vs. U. S. Fidelity & G. Co., 236 U.S. 549, 545-555. This purpose of the Act has been again and again emphasized by the courts as being a public as well as private interest, in that it is to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt. (Citing numerous cases) . . . The various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the Act. Local Rules subversive of that result cannot be accepted as controlling the action of a Federal Court."

II.

THE UNITED STATES DISTRICT COURT MAY TAKE EXTRINSIC EVIDENCE TO DETERMINE THE CHARACTER OF THE DEBT WHICH ALLEGEDLY HAS NOT BEEN DISCHARGED BY BANKRUPTCY.

There is abundant authority that in ascertaining whether a udgment was discharged in bankruptcy, the Court may go behind he Judgment, examine the entire record, and determine therefrom he nature of the original liability, and when necessary, extrinsic vidence may be received for the purpose of determining the haracter of the debt.

Pepper v. Litton, 308 U.S. 295, 307-308 (1939);

Greenfield v. Tuccillo, 129 F.2d 854, 856 (2nd Cir.);

Swig v. Tremont Trust Co., 8 F.2d 943, 945 (1st Cir., 1925);

U. S. Credit Bureau v. Manning, 147 Cal.App.2d 558, 561 (1957);

Yarus v. Yarus, 178 Cal.App.2d 190, 196 (1960);

Fidelity & Casualty Co. v. Golombusky, 133 Conn. 317, 51 A.2d 817.

Appellant in his opening brief at page 26, cites and quotes itzgerald v. Herzer, 78 Cal.App.2d 127 (1947) as follows:

"Whether a judgment is cancelled by a Discharge in Bankruptcy depends on the nature and the character of the liability for which it was recovered. Therefore, in ascertaining whether the judgment upon which the

instant action is based was discharged, the Court will go behind the judgment, examine the entire record, and determine therefrom the nature of the original liability, and when necessary, extrinsic evidence will be received for the purpose of determining the character of the debt. (Cases cited)."

The above general principle is stated in the Referee's Conclusion of Law III. Appellant admits the correctness of this general principle in his opening brief where he says at page 29:

"Our grievance with the Referee is not in the general law which he sets forth in Conclusions of Law I, II and III, but in his application of those rules."

Appellant goes on to state that the rule that extrinsic evidence may be admitted to show the true character of a debt does not apply where there has been a judgment in a State Court action alleging fraud and the judgment has been entered pursuant to the defendant's default. Here we come to the crux of this appeal: whether extrinsic evidence of the character of the underlying debt can be heard by a Referee where there is a judgment by default in a State Court action in which one of the causes of action alleges fraud?

It is stated by appellant that the general rule is that a defendant admits the truth of the material allegations of a complaint,

which are well pleaded, if the defendant defaults. Whether this is, or should be, the rule in a bankruptcy proceeding, is another matter. It seems relatively easy for collection agencies and small loan companies to include in their complaints a cause of action for fraud and to submit an affidavit that technically supports the fraud allegations. And it is a matter of common knowledge that debtors often will permit a default to be entered because they contemplate going through bankruptcy and obtaining a discharge of the obligation. And they are unaware that in the later bankruptcy proceeding the judgment creditor will rely on the allegation of fraud and the affidavit in support thereof to make the debt non-dischargeable. The debtor is thus lulled into a sense of security and is unaware that the complaint which he has been called upon to answer contains a trap to the unwary. The concept that a defaulting defendant admits the material allegations of a complaint is a highly technical one at best and does not truly reflect any debtor's actual state of mind and should not be applied in bankruptcy matters, and if applied, should be very strictly construed.

The principal cases relied upon by appellant are Fitzgerald v. Herzer, 78 Cal. App. 2d 127 (1947); Van Epps v. Aufdenkamp, 38 Cal. App. 622, and Wilson v. Walters, 19 Cal. 2d 111 (1941).

Before discussing these cases, let us clearly establish the relevant facts of the instant case. A complaint was filed in the Los Angeles Superior Court alleging three common counts for $3,991.93 and a fourth count for $3,990.50, the fourth being a cause of action alleging false pretenses and fraudulent representa-

ions (Appellant's Exhibit "A"). An affidavit was submitted to the Court in the above Superior Court action and a judgment was entered for $3,990.50, plus interest and costs. The affidavit (Appellant's Exhibit "B") established the amount of the debt; to wit, $3,990.50 but it did not, in the opinion of the Referee, establish that the basis of the debt was fraud. In the words of the Referee (R.T., p. 2):

> "I cannot bring myself to feel that there were actually false representations in this case. . . . A review of the Exhibit attached to the complaint and the affidavit filed in the State Court action would indicate that this was nothing more than an ordinary business transaction. . . . "

The two crucial points, and the points which will distinguish the instant case from those quoted by appellant are first that the judgment did not purport on its face to be a judgment for fraud, and second, that the record of the State Court action contained an affidavit that negatived any possible inference that fraud was present.

Now, let us examine the three California cases principally relied on by appellant. First, Fitzgerald v. Herzer, supra: There, the complaint in the State Court action alleged that the defendant had driven in a wanton, reckless and negligent manner. The defendant defaulted and judgment was thereupon entered. The judgment in that case purported on its face to be one for conduct not dischargeable by bankruptcy; to wit, wanton misconduct.

Neither did the record contain an affidavit that would have negatived the inference of wantonness purportedly raised by the defendant's default. In the instant case, the State Court Judgment did not purport on its face to be a judgment on the fourth cause of action for fraud. The fact that the amount of the judgment was for the amount claimed in the fraud count and not for the amount claimed in the other three counts is of no significance. The State Court could have determined that the affidavit established both that the amount of the debt was the amount alleged in the fraud claim and also that the basis for recovery was any or all of the first three counts and not the fourth. The judgment is thus, at best, ambiguous as it does not purport to be a judgment on any particular cause of action. In view of the patent ambiguity of the judgment itself and in further view of the existence of an affidavit which would suggest that the judgment probably was not based on fraud, the Fitzgerald case, where neither of these two factors was present, cannot be authority in the instant action.

The second case cited by appellant is Van Epps v. Aufdenkamp, supra. In that case the complaint in the State Court alleged an unlawful conversion and a judgment was entered upon the default of defendant. The Court there held that such a conversion was willful and malicious and that therefore, the judgment based thereon was not discharged by the bankruptcy. The judgment in that case was not ambiguous, nor was there an affidavit that would have cast doubt on the willfulness and maliciousness of the defendant's conduct; therefore, Van Epps is clearly distinguishable.

In Wilson v. Walters, supra, the creditor filed suit on two ounts, the first alleging breach of contract, and the second lleging fraud. Defendant stipulated for judgment in accordance ith the allegations of the complaint and the judgment itself recited at it was in accordance with the allegations of the complaint. In iew of that, the Court held that the defendant in that action could ot thereafter deny the fraud nature of the judgment. Thus in Vilson, both the stipulation and the judgment specifically and nambiguously encompassed both the contract count and the fraud ount. In the instant case, there was, of course, no stipulation, nd the judgment did not unambiguously refer to the fraud count. herefore, Wilson is also distinguishable.

Appellant has neither quoted nor cited any case in which ie purported rule that a default admits the material allegations of complaint, has been applied where it is uncertain whether or not ie judgment is on the fraud action, or where in addition to the mplaint alleging fraud there is other evidence in the record (in is case, an affidavit) which contradicts any inference of fraud that ight have been raised by the failure to answer.

However, there are a number of Federal cases which ggest that where the judgment is ambiguous or where a record gatives an inference of fraud, a default will not be conclusive. hus, in Williams v. Colonial Discount Company, 207 F. Supp. 362 .D. Geo. 1962), at page 368, the Court remarked:

"It has been said that although the pleadings in the State Court might show willful and malicious

injury, if the rest of the record negatives such character, the judgment is dischargeable. See Collier on Bankruptcy, 14 ed. Vol. I, p. 16, 17 containing the following:

" 'Where a judgment has been obtained, the Court which is called upon to determine whether the judgment is dischargeable, may resort to the entire record to determine the wrongful character of the act.' "

Personal Industrial Loan Corporation v. Forgay, 240 F. 2d 3 (10th Dis. 1956), contains the following significant language:

"The default judgment it obtained was merely for the amount of its claim and did not purport to be a fraud judgment. In fact, the judgment did not refer to fraud in any way."

Thus, the Court in that case emphasized the importance of a judgment unequivocally referring to fraud if that judgment is to be a basis for objecting to a debtor's discharge, even in the presence of a default.

In re Caldwell, 33 F. Supp. 631 (N. D. Geo. 1940), involved a State Court Default Judgment upon a complaint in deceit. The Court there held that the complaint did not unambiguously refer to fraud within the meaning of the Bankruptcy Act, and that therefore the judgment obtained thereon was not conclusive of the issue. In

ne words of the Court:

> " . . . or if the allegations of the petition are vague, ambiguous, or indefinite, or mere conclusions of the pleader, then the judgment rendered on such petition will be construed to be an ordinary judgment dischargeable in Bankruptcy."

Thus, the Court laid particular emphasis on the need in a ate Court complaint for allegations that are unambiguous and efinite. We submit that this case is authority for the proposition at for the judgment to be conclusive it also must be unambiguous d definite. The Court in that case went on to conclude:

> "If creditors, with their expert credit men, were as diligent in investigating the responsibility of applicants for credit and as prudent in distilling it, as they are persistent and sometimes oppressive in attempting to collect after the indebtedness has been incurred, there would be fewer claims of fraud and attempts like this to defeat a discharge in bankruptcy."

It is submitted that that Court looked with a jaundiced eye the efforts of a creditor to convert a purely business debt for e purchase of merchandise into non-dischargeable fraud. This urt should look with the same jaundiced eye toward this creditor's milar attempt.

The District Court's decision in that case was affirmed in Davison-Paxton v. Caldwell, 115 F. 2d 189 (5th Cir. 1940), where the Court laid down the following general policy consideration:

> "A remedial statute like that of bankruptcy intended for the relief of debtors, must insofar as denial of discharges and therefore of relief, be construed strictly so that all debts except those coming exactly within the exception will stand discharged."

In the instant case the complaint contained several counts, one of which was for fraud, but the judgment did not contain a finding of fraud, nor did it specially refer to the fraud count. Hence the only cases truly relevant are those where there is a default in respect to a complaint alleging several counts, only one of which is dischargeable, and where the judgment thereupon entered does not clearly indicate it is being based on the non-dischargeable count.

Two such cases are Valdez v. Sams, 134 Colo. 488, 307 P. 2d 189 (1957), and Freedman v. Cooper, 126 N. J. L. 177, 17 A. 2d 609 (1957), both being Supreme Court decisions of their respective states.

In Freedman, supra, the complaint "made the allegations of negligence usual in automobile damage suits including inter alia the allegation that defendant's automobile was driven 'in such other (sic) reckless, careless, willful, wanton and negligent manner as to evince a reckless disregard for human life and

afety' . . . and a default judgment was entered."

The Court then posed the question: "Was the judgment one hat by its nature was not subject to release by a discharge in ankruptcy? . . . " In determining that the judgment was dischargeable, the Court reasoned as follows:

> "In the present case the judgment could have been upon one or more of a variety of theories upon which the complaint was grounded, . . . In so far as I can determine from the proofs and papers before me the act upon which recovery was had was one of negligent driving. . . . I am not disposed under these circumstances to hold that the judgment is for willful and malicious injuries."

Freedman was quoted with approval in Valdez, supra. here the Court said: "We are in accord with the views expressed by the Supreme Court of New Jersey in Freedman v. Cooper . . . ". Freedman was specifically approved by the Colorado Supreme Court in an opinion which expressly rejected the views expressed in Fitzgerald v. Herzer, supra, on which appellant relies so avily. To quote the Valdez decision:

> "The case is one of first impression in this jurisdiction, and we are not impressed with the reasoning of the California Court of Appeal in Fitzgerald v. Herzer, 78 Cal. App. 2d 127, 177 P. 2d 364. . . . "

In Valdez, the question before the Court was:

"Where in an action to recover judgment for damages resulting from an automobile collision, the complaint contains an allegation that the defendant was guilty of negligence consisting of a 'reckless or willful disregard of the right or safety of others'; and where default of defendant was entered and thereafter the court heard evidence in support of the allegation of the complaint and entered judgment without specifically finding that more than simple negligence was shown . . . is the debt evidenced by the judgment an obligation which is extinguished by a discharge in bankruptcy?"

he Court concluded:

"The question is answered in the affirmative. . . . If plaintiffs desired to protect themselves against the possibility that defendant might seek a discharge in bankruptcy, it was incumbent on them to secure a specific finding in the trial court that the negligence of defendant was such that a discharge in bankruptcy would not operate to release the judgment. No such finding was made."

On the basis of the above two decisions, we submit that if ppellant herein wishes to rely on the State Court judgment by fault as conclusively establishing a non-dischargeable debt: to t, fraud, his State Court affidavit should have set forth facts

howing fraud and his State Court judgment should have been pecifically on the fraud cause of action, and should have included finding of fraud. Otherwise a non-dischargeable obligation would e created without the creditor having to prove the non-dischargeble nature of the debt. The policy considerations implicit in the ankruptcy Act preclude such a result.

III.

A PERMANENT INJUNCTION WAS APPROPRIATE AND IT WAS NOT NECESSARY TO MAKE A SPECIFIC FINDING OF FACT THAT THE STATE COURT REMEDY WAS INADEQUATE.

In In re Caldwell, 33 F. Supp. 631, supra, the U. S. District ourt permanently enjoined the creditor from undertaking to nforce the judgment obtained in the State Court or from in any way ttempting to collect that judgment. No specific finding of fact as made that the State Court remedy was inadequate, and on peal in Davidson-Paxton v. Caldwell, supra, the District Court's ermanent Injunction was upheld. It is submitted on the basis of te above case, that the Federal Courts have the discretion to isue a Permanent Injunction without making an express and ecific finding of inadequacy of State remedy.

The broad discretion Federal courts have in issuing injunctons to prevent State Court enforcement of discharged judgments i discussed at length by the United States District Court in Personal ldustrial Loan Corp. v. Forgay, 140 F. Supp. 473 (D. C. Utah, 1956).

The Court cited and discussed a number of cases in which use of the injunctive power was upheld, summarizing with a statement referring to the "almost unlimited scope of facts upon which injunctive relief has been granted".

The Court went on to discuss the policy considerations underlying the liberal use of the Federal Courts' injunctive power, emphasizing the general inadequacy of a State Court remedy. The Court concluded:

> "Almost invariably loan company creditors contest the discharge of bankrupt upon the ground that the loan was induced by fraud and is not dischargeable. A judge comes to learn that such objections to the discharge must be scrutinized with great care. . . . If the Loan Company's view is upheld there will be no more objections to discharges filed in the bankruptcy court in cases of this kind. Loan companies will seek default judgments in the city courts."

We think that the judge's attitude toward the practice of obtaining a default judgment in a State Court on a complaint alleging fraud is apparent.

For another case discussing the inadequacy of State remedies, see Seaboard Small Loan Corp. v. Ottinger, 50 F. 2d 56 (CCA 4, 1931).

It should be especially noted that appellant cites no case in which a federal court's issuance of an injunction restraining

collection of a State Court judgment on a dischargeable debt has ever been reversed. And with good reason. For as the Court said in Forgay, supra, the facts upon which injunctive relief has been granted are "almost unlimited (in) scope".

IV.

APPELLANT WAIVED ANY OBJECTION HE MIGHT HAVE HAD TO THE INTRODUCTION OF EVIDENCE ON THE NATURE OF THE UNDERLYING DEBT.

Appellant did not at the time of the original hearing object o the introduction of evidence of the true character of the debt iving rise to the State Court judgment. It is a general rule of vidence that objections to evidence not made at the time such vidence is offered are waived. United States v. Aluminum Co. of merica, 35 F. Supp. 820. Having treated the nature of the under- ying debt as in issue at the hearing, appellant waived his right to hallenge the referee's taking evidence on that issue.

CONCLUSION

In view of the patent ambiguity of the State Court Judgment and in further view of the Affidavit submitted to the State Court which negatived the existence of fraud within the meaning of the Bankruptcy Act, it is urged that the Referee acted within established principles when he took evidence to determine the true nature of the obligation sued on in the State Court. It is further urged that the issuance of a Permanent Injunction was proper in view of the United States District Court's inherent power to implement its orders for discharge in bankruptcy matters.

Respectfully submitted,

BLANCHARD & CRISPI and

RICHARD H. LEVIN

By /s/ Richard H. Levin
RICHARD H. LEVIN

Attorneys for Respondent.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that in my opinion this brief is in full compliance with those rules.

/s/ Richard H. Levin
RICHARD H. LEVIN